Internal Revenue Service
memorandum

CC:TL:Br3
DAMustone

date: APR 4 1988

to: District Counsel, San Jose W:SJ
Attn: J. Paul Knap

from: Director, Tax Litigation Division CC:TL

subject: Technical Advice - [redacted]

By memorandum, dated March 18, 1988, it was requested that the Tax Litigation Division provide technical assistance with respect to the above litigation. The issue involved has been discussed on several occasions with J. Paul Knap of your office. The following discussion more fully sets forth our views on this issue.

ISSUE

Whether the contribution of real estate to a defined benefit plan by the sponsoring employer (presumably in satisfaction of its obligation to fund the plan) constitutes a prohibited transaction for purposes of IRC § 4975.

CONCLUSION

While we believe that contributions of property (which are commonly known as "in-kind contributions") should generally be treated as prohibited transactions, it is our conclusion that the theory espoused by the Department of Labor (which has the exclusive authority to issue opinions regulations, etc., under § 4975(d)(1)) with respect to such contributions is not defensible. In any event, the arrangement involved was apparently of substantial benefit to the plan and therefore, the instant litigation would not serve as a good "test case" for the in-kind contribution issue. Accordingly, we recommend that the case be conceded in the event that a settlement cannot be reached.

DISCUSSION

For the plan years ending [redacted] and [redacted], the contributions required to be made to the [redacted] Defined Benefit Pension Plan was $[redacted] and $[redacted] respectively.[1] To satisfy these obligations, the taxpayer contributed some cash and "credits", along with [redacted] "developed" lots. See notice of Deficiency (accompanying Explanation of Items). The total fair market value of the [redacted] lots contributed for [redacted] (together with the cash contributed) apparently exceeded the required contribution for that year; and the total assessed value of the lots contributed for [redacted] exceeded the required contribution for that year. Lastly, there is nothing to indicate that the transferred lots were encumbered by a mortgage or similar lien.

Under § 102 of the Reorganization Plan No. 4 of 1978, the Secretary of Labor has essentially been delegated the exclusive authority to determine what constitutes a prohibited transaction for purposes of § 4975. And, in general, the Department of Labor (DOL) considers an in-kind contribution to a defined benefit plan in satisfaction of the employer's obligation to fund the plan to be a prohibited transaction. See DOL Opinion Letter 81-69A (July 28, 1981). The drawback here is that DOL's underlying theory for treating such contributions as prohibited transactions is based upon the incorrect premise that § 412 (the minimum finding provision) obligates an employer to make the required contribution in cash. See DOL letter to Chief Counsel, I.R.S., dated March 8, 1985. Therefore, it is our view that DOL's current theory is not defensible and, because of the Reorganization Plan, we are not free to take an approach which varies from that taken by DOL.

Of course, the IRS generally agrees with DOL that in-kind contributions should be treated as prohibited transactions.[2] As a consequence, at the behest of the IRS, DOL is currently in the process of reexamining its position on the issue. However, until further guidance is provided we are obligated to follow the existing pronouncements.

1/ Presumably, these amounts represented at least that which was necessary to the meet the minimum funding requirements under IRC § 412 for those years.

2/ This is due primarily to the potential for abuse in this context. For example, an employer can make a contribution of property in order to rid itself of a bad investment.

In any event, given that the contributed property was of substantial benefit to the plan, we do not believe that this would be an appropriate case in which to present the issue to the Tax Court for the first time. Rather, it is our view that the "test" case should involve as abusive a set of facts as possible in order to illustrate the potential for evils that can arise.

If we can be of any further assistance, please contact David Mustone of this Division at 566-3407.

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